91-681 (1)

Supreme Court, U.S.
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No. -

In The

Supreme Court of the United States

October Term, 1991

CHEMUNG CANAL TRUST COMPANY, as Trustee of the Fairway Spring Company, Inc. Restated Pension Plan,

Petitioner,

vs.

SOVRAN BANK/MARYLAND,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

Under ERISA, may a former plan trustee which had full authority and responsibility for investment decisions, in a suit against it by its successor trustee, counterclaim against its successor for contribution and indemnity against damages assessed against the former trustee as a result of investment losses?

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OPINIONS BELOW

The opinion of the Court of Appeals (reproduced at Appendix 27) (hereinafter "A"), issued on July 25, 1991, is reported at 939 F.2d 12 (2d Cir. 1991). The opinion of the District Court, issued on December 27, 1990 (A-15), is reported at 753 F. Supp. 81 (W.D.N.Y. 1990).

JURISDICTION

The judgment of the Court of Appeals was dated and entered on July 25, 1991. (A-27) Jurisdiction to review the judgment of the Court of Appeals is conferred on this Court by 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS

This petition involves various provisions of the Employee Retirement Income Security Act ("ERISA") (29 U.S.C. ch. 18), especially 29 U.S.C. § 1103(a), 29 U.S.C. § 1104(a), 29 U.S.C. § 1105, and 29 U.S.C. § 1132. The provisions involved are lengthy, and their pertinent text is set forth in the Appendix to the Petition of Fairway Spring Co., Inc. and incorporated by reference.

STATEMENT OF THE CASE

Introduction

This case presents to the Court an important question of federal law on which there are conflicting decisions of the Courts of Appeals which needs to be settled by this Court. The decision of Second Circuit Court of Appeals, now appealed from, creates, for the first time in any jurisdiction, a right on behalf of a former investment trustee under the Employee Retirement Income Security Act of 1974 ("ERISA") to sue its successor for contribution

and indemnity. Other federal courts, including the Ninth Circuit Court of Appeals, have reached a contrary conclusion.

FACTS

Co-petitioner Fairway Spring Co., Inc., a small specialty manufacturing business in upstate New York, established a pension plan to provide retirement income for its employees. Unfortunately, between 1982 and 1984, the trustee of the Plan, one Glen E. Dawson, invested its funds in a series of investments which turned out to be fraudulent or imprudent. As a result, the Plan incurred sizeable losses. There is no dispute that the investments were blatantly improper and violated ERISA "prudent man" standards. 29 U.S.C. § 1104(a)(1).

In February, 1985, before any losses were realized or suspected, Dawson was succeeded as trustee of the Plan by respondent Sovran Bank/Maryland (hereinafter "Sovran"). The full extent of the irregularities eventually became apparent to Fairway when Sovran wrote off the investments in its 1988 annual report. In August, 1989 Fairway fired Sovran as trustee and hired petitioner Chemung Canal Trust Company (hereinafter "Chemung") in its place.

Chemung and two plan beneficiaries commenced this action against Sovran in the United States District Court for the Western District of New York for neglecting its fiduciary duties under ERISA. The complaint alleged that Sovran failed to investigate the Plan's investments, failed to dispose of the improper investments, and failed to bring timely claims against the original trustee, Dawson, and the bond and insurance companies from whom claims against Dawson could have been recovered within the time limits provided in the bond and insurance policies. The complaint also alleged that Sovran itself had made additional im-

prudent investments and failed to diversify investments. On behalf of the Plan, Chemung sought damages of $1,507,313.34, plus interest, against Sovran.

Sovran then filed a third-party complaint charging Fairway Spring Co., Inc. itself, Fairway's officers and directors, its attorney, and unnamed persons alleged to be members of an investment committee (hereinafter collectively referred to as "Fairway") with responsibility for the Plan's losses. Sovran sought indemnity and contribution against Fairway for allegedly failing to discover and correct Dawson's breaches itself and for failing to disclose them to Sovran. The relief demanded included both the damages sustained by the Plan and damages to Sovran. Sovran also filed a counterclaim for indemnity and contribution against Chemung, which had aggressively instituted legal proceedings to recover the Plan's losses within five months after becoming Trustee.

Decisions of the District Court and Court of Appeals

Upon a Rule 12(b)(6) motion by Chemung, the District Court (Telesca, U.S.D.J.) dismissed the counterclaim against Chemung on the grounds that Sovran lacked standing to bring suit on behalf of the Plan and that ERISA provides no right of contribution or indemnity from co-fiduciaries. The District Court then issued an order under FRCP 54(b) authorizing entry of a final judgment as to the counterclaim so as to permit an immediate appeal.

The Second Circuit Court of Appeals affirmed in part and reversed in part. The court was unanimous in affirming the holding that Sovran lacked standing to sue for damages on behalf of the Plan. Although the majority agreed with Judge Telesca that the methodology of *Cort v. Ash*, 422 U.S. 66, 45 L. Ed. 2d 26 (1975) could not support an implied cause of action for contribution or

indemnity under ERISA, the majority decided that a right of contribution should nevertheless be recognized as a matter of "federal common law." (A-34).

Judge Altimari dissented from the majority holding, stating that in his view "if Congress had intended to include a right of action for contribution and indemnification it would have done so." (A-41).

Basis for Federal Jurisdiction of the District Court

The District Court had jurisdiction of the action in the first instance under section 502(e)(1) of ERISA (29 U.S.C. § 1132(e)(1) which gives the district courts exclusive jurisdiction of civil actions under ERISA.

WHY THE PETITION SHOULD BE GRANTED

A. *The decision of the court below conflicts with decisions in other circuits regarding a right to contribution or indemnity under ERISA.*

The fundamental issue presented by Sovran's counterclaim is whether an ERISA plan trustee may seek contribution or indemnity from a successor trustee. It is important to note the nature of the conduct of Chemung for which Sovran seeks contribution. Sovran first alleges that at the time Chemung was appointed trustee of the Plan, the Plan had certain outstanding claims arising from various investments held by the Plan. It then alleges that, upon its appointment as trustee, Chemung failed to investigate and pursue these claims held by the Plan and therefore contributed to the losses alleged in the complaint. Since these claims which Sovran alleges Chemung failed to investigate and pursue were allegedly outstanding when Chemung became trustee, they

are the claims for which Sovran is being sued. In other words, Sovran is suing Chemung for not pursuing the very claims for which Chemung is suing.

The holding of the Second Circuit Court of Appeals that a right of contribution may be asserted as a matter of "federal common law" conflicts with decisions of the Ninth and Seventh Circuit Courts of Appeals and with district court decisions in other circuits. The discussion of the authorities on this point set forth in the petition of Fairway Spring Co., Inc., et al. is incorporated by reference.

B. *The creation of a new right of contribution disrupts the legislative balance struck by Congress in crafting ERISA.*

Failing to appreciate that Congress had already enacted detailed legislation in the area of co-fiduciary liability, the majority below also failed to consider the extent to which the creation of a new right of contribution "might upset carefully considered legislative programs." *Northwest Airlines, Inc. v. Transport Workers Union*, 451 U.S. 77, 97, 67 L. Ed. 2d 750, 767 (1981).

The result portended by the Second Circuit will discourage trustees such as Chemung from accepting the responsibility for a trust in which the investments are in disarray. As successor trustee, Chemung has a duty to the Plan and its beneficiaries to pursue claims arising from imprudent investments made in the past. It exercises discretion at its peril and if it fails to act properly, it may be liable to the Plan and to beneficiaries. Congress spelled out when it might be responsible. 29 U.S.C. § 1105(a). Congress did not spell out that it might be liable to a former trustee, Sovran, because it failed to sue other fiduciaries or former fiduciaries. Most of the responsible parties, such as former trustee Dawson and his company Chesapeake Pension Consultants, Inc., the securities salesman George Schnabel, and the investment companies First American Mortgage Company

and Government Financial Services, Inc. were bankrupt. Fairway, by virtue of annual employer's contributions made to the Plan to restore required funding of benefits, was voluntarily compensating for the problem. Chemung, as trustee, should have and was given by Congress the authority and responsibility to pursue these claims for the best interests of the Plan. The Second Circuit improperly added to the Congressional plan the right of a defendant to sue the plaintiff on the grounds that others had not been sued.

This Court stated in *Russell* that it was "reluctant to tamper with an enforcement scheme crafted with such evident care as the one in ERISA." *Massachusetts Mutual Life Insurance Co. v. Russell,* 473 U.S. 134, 147, 87 L. Ed. 2d 96, 106 (1985). The Second Circuit clearly did not share that reluctance, however, and its decision should be reviewed by this Court.

C. *The issue of the right of contribution among ERISA co-fiduciaries is a federal question which has not been but should be settled by this Court.*

There are thousands of ERISA plans throughout the United States. Under ERISA, the employer and, if the employer is a corporation, each director of the corporate employer, is included in the definition of fiduciary. Employers, both corporate and individual, have chosen in most cases to delegate responsibility for investment decisions to a professional trustee, usually either a trust company or insurance company. While those corporate owners and directors felt responsible to individual plan beneficiaries for exercising good judgment in selecting the corporate trustee, they felt secure from claims by the professional trustee that the corporate owners and directors should supervise and share responsibility for the professional trustee's investment decisions. Under the Second Circuit's decision, those corporate owners and directors have suddenly become exposed to suit by

the imprudent professional trustee. With a split between the Second Circuit and the decisions in other circuits referred to in the Fairway petition and incorporated by reference therein, thousands of business owners and directors are uncertain as to their duties and liability. Faced with the inability to delegate investment responsibility to professional trustees, many corporate directors may choose not to serve as directors and many corporate owners may choose not to continue retirement plans. A definitive answer is urgently needed by the business community.

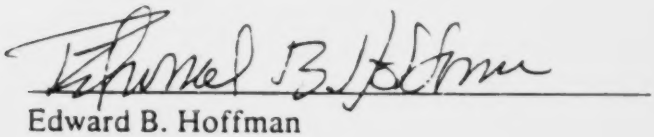
CONCLUSION

In the face of a comprehensive statute in which Congress has already addressed rights of co-fiduciaries, the courts are not warranted in creating a new right of contribution or indemnity in favor of one ERISA fiduciary against a co-fiduciary under the guise of "federal common law." The recognition of a right of contribution threatens, moreover, to upset the "carefully considered legislative program" represented by the ERISA statute.

The circuit courts are divided on this issue. It is an important federal question which needs to be settled. It is respectfully urged that the Court grant the petition and set the case for argument.

Dated: October 21, 1991.

Respectfully submitted,



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